No. 11,643

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

Bloomfield Ranch, by James A. Clayton & Co., a corporation, managing partner, operator and co-owner thereof, and by Florence G. Baldwin, John Derrol Chace, Willis Sherman Clayton, Jr., Arthur D. Curtner, John Kirk Dorrance, Rose L. Fitch, Margaret F. Coykendall, Hugh S. Hersman, Alfred A. Hapgood, George H. Osen, Alfred L. Parkinson, Estate of Andrew R. Patrick, deceased, by Sigurd C. P. Cornett, as executor of the will of Andrew R. Patrick, deceased, San Jose Hardware Co., a corporation, Nellie Shillingsburg, Anne Thompson, Sarah Shillingsburg Barry, Margaret Leaman, and Estate of Ellen Weinstein, deceased, by Wells Fargo Bank & Union Trust Co., executor, substituted for Estate of Samuel Weinstein, deceased, by Ellen Weinstein, as executrix of the will of Samuel Weinstein, deceased, partners in and co-owners of Bloomfield Ranch,

Petitioners on Review,

vs.

Commissioner of Internal Revenue,

Respondent on Review.

On Petition for Review of Decision of the Tax Court of the United States.

BRIEF FOR PETITIONERS.

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Subject Index

Table of Authorities Cited

Cases

Statutes

Miscellaneous

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BRIEF FOR PETITIONERS.

JURISDICTION.

This petition for review involves income taxes and declared value excess profits tax for the year 1940. (R. 212.) A partnership return of income for the calendar year 1940 was filed with the Collector of Internal Revenue for the First Collection District of California (R. 212) under the name "Bloomfield Ranch" showing the respective shares of taxable income of petitioners herein in the so-called Bloomfield Ranch properties. (R. 190.) The First Collection District of California is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit. All the individual petitioners are residents of, and James A. Clayton & Co., the corporate petitioner, has its principal place of business in, the Northern District of California, which is within the jurisdiction of the United States Circuit Court of Appeals for the Ninth Circuit. The notice of deficiency was mailed to the taxpayer on February 28, 1944 (R. 19) in which the Commissioner asserted a deficiency for the year 1940 of $6,646.60 in income tax liability and $4,159.58 in declared value excess profits tax liability. Within ninety days after the mailing of the notice of deficiency, petitioners, on May 22, 1944, filed in the Tax Court of the United States their petititon for redetermination of that deficiency (R. 3, 6) under the provisions of Section 272(a) (1) of the Internal Revenue Code. On June 30, 1944, the Commissioner of Internal Revenue filed in the Tax Court of the United States his answer to the petition. (R. 3, 23.) The Tax Court of the United States, on January 31, 1947, filed its memorandum of findings of fact and opinion and its

decision (R. 4, 212-227) sustaining the ruling of the Commissioner. The petitioners within three months thereafter, on April 21, 1947, filed in the office of the Clerk of the Tax Court of the United States their petition for review of the decision by the United States Circuit Court of Appeals for the Ninth Circuit (R. 5, 239) pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

QUESTIONS PRESENTED.

James A. Clayton & Co. (hereinafter sometimes called "Clayton"), a real estate agent, found thirteen individuals who contributed $50,000 each, to be used together with $50,000 contributed by Clayton and money to be borrowed, in purchasing lands, hereinafter referred to as "Bloomfield", for the profitable resale thereof. Each individual investor made a separate agreement with Clayton under which Clayton was to sell the property and distribute the proceeds to the respective investors. Each investor was to be paid his share from time to time whenever there should be a net of $7,000 or more on hand. The title was taken in the name of M. E. Thomas who made deeds to the buyers when sales were made by Clayton.

The questions are whether, as petitioners contend, petitioners were in 1940 a partnership as that term is defined in Sec. 3797(a) (2) of the Internal Revenue Code; or whether their venture was taxable as a corporation; whether they were carrying on business; and whether the Tax Court erred in holding that peti-

tioners are liable for a deficiency for the year 1940 of $6,646.60 in income tax liability, and $4,159.58 in declared value excess profits tax liability.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are set forth in the appendix, *infra*, pp. i-vii.

STATEMENT OF THE CASE.

James A. Clayton & Co. is a corporation, organized under the laws of California, and having its principal place of business in San Jose, in said State, and doing business as a real estate agent and broker. (R. 203, 204.)

Miller & Lux, Incorporated, a corporation, owned 21 separate parcels of land, substantially all ranch land, in the Counties of Santa Clara, San Benito and Santa Cruz, California, containing about 27,500 acres. Clayton, having learned, about the beginning of 1926, that the lands were for sale as a whole, and deeming that they presented a favorable opportunity for purchase and profitable resale in such parcels as the purchasers might require, found thirteen customers willing to go into the investment. Each contributed $50,000, in January and February of 1926. Clayton also contributed $50,000. Thus there were fourteen investors. (R. 204-205.)

Clayton and each investor, including Clayton & Co., separately signed agreements dated March 10,

1926. The fourteen respective agreements were identical except for the names of the respective investors (R. 53) and read as follows (R. 167):

$50,000.00 San Jose, Cal. March 10, 1926

This is to acknowledge receipt by the undersigned, James A. Clayton & Co., a corporation of San Jose, Cal., hereinafter called the "Operator", from J. P. Dorrance of San Jose, hereinafter called the "Investor", of the sum of Fifty Thousand ($50,000.00) Dollars, which sum is so received by, and paid to, said corporation on the terms and conditions and for the purposes, as hereinafter set forth and not otherwise, to-wit:

The Operator is to use said sum, together with other sums contributed by thirteen other persons, who are also referred to herein as "Investors" and other sums borrowed or advanced by said operator—the unpaid portions thereof, may be reborrowed or renewed, and security given—in the purchase of certain lands and interests, in the Counties of Santa Clara, San Benito and Santa Cruz, California, belonging to Miller & Lux, Inc., and consisting of approximately 27,000 acres of land, together with divers rights, appurtenances and easements as described in three deeds to M. E. Thomas dated March 3rd, 1926 and recorded March 10th, 1926 in Santa Clara, San Benito and Santa Cruz Counties, Cal.

The Operator is to take and hold title to said properties originally in the name of M. E. Thomas; but may take such title in the name of any other person, corporation or concern, or in its own name; and may have such title conveyed, from time to time, to other persons, corporations or concerns, or otherwise conveyed or held, as the

Operator may desire, in trust for the said 14 investors above referred to, for the profitable resale thereof.

The Operator may sell, convey, hold, lease for one season only, or in any otherwise deal with and treat said properties as the sole and absolute owner thereof in fee simple, and without let or hindrance from the Investor, or any of the Investors, less than the full number thereof, or any other person or concern, whatsoever. But may not exchange, encumber, nor lease except as above specified, nor sell trees, wood or improvements off from said property without the consent of the investors.

The Operator may, from time to time, incur such costs, expenses, and charges in connection with the acquiring, holding, renting, selling or protecting of said properties, as it may deem proper; and the fact of the Operator incurring such cost, expense or charge, shall conclusively establish the propriety and legality thereof.

The Operator shall keep true and accurate books of account, in which shall be set down, from time to time, all moneys paid out and charges, expenses and costs incurred in the premises, and all sales made and properties disposed of, and moneys or other things of value received by it in the premises.

Out of the moneys received from sales or renting or other sources of said properties, the Operator shall first retain for its own use and benefit, a commission of five percentum (5%) on the gross selling price of each parcel sold, as sales are made, and from the net proceeds of such sales, after deduction of its commissions, the Operator shall pay all costs, expenses, and

charges paid or incurred by it in the premises, and all moneys advanced or borrowed by it, together with interest thereon.

From any residue of moneys remaining in the Operator's hands, after all the foregoing payments have been made, the Investor shall be entitled to have returned to him, at the same time, and in equal amounts, as are returned to the other Investors, the whole or such part of the said sum herein receipted for, as may, in the judgment of the Operator, be safely paid, without jeopardy to any remaining properties or assets, not yet converted into cash; but no Investor shall be entitled, as of right, to any payment or return, or repayment before said properties and the proceeds thereof, have been converted into cash, and all such commissions, debts, advances, costs, charges and expenses have been fully paid, provided, however, that upon the payment of the debts, taxes and charges accrued, such funds shall be distributed equally to said Investors whenever there shall be a net amount of $7000 or more on hand.

When, as, and if all of said properties, and all properties, and all proceeds therefrom shall have been sold and converted into cash, and all such commissions, debts, advances, costs, charges and expenses shall have been fully paid, and all moneys advanced by the Investors shall have been fully repaid, all moneys, if any, then remaining in the hands of the Operator arising out of said transactions, and not applicable to any of the foregoing requirements, shall be, by said Operator, paid to and divided among the Investors, in equal shares to each of them, their heirs and assigns.

It is authorized, understood and agreed, however, that the Operator has charged, and is entitled to a commission of Fifty Thousand ($50,000.00) Dollars for the negotiation, purchase and consummation of sale of said properties from Miller & Lux, Inc., to said M. E. Thomas, which is in addition to commissions to be credited to it for subsequent resales, and which shall be added to, and included in charges and expenses of the transactions herein provided for, and accounted as part of the original purchase price of said properties.

The Investor shall be entitled to have an account rendered to him by the Operator, of all transactions hereunder, on demand, but not more often than once each sixty days.

These presents are executed in duplicate by the Operator and the Investor, the day and year set out at the opening hereof, and shall be binding upon the successors, heirs, representatives and assigns of each of them.

James A. Clayton & Co.,
By Frazier O. Reed,

Its President,

W. S. Clayton,

Its Secretary,
Operator

J. P. Dorrance,

Investor

The Tax Court made findings, in part as follows:

On March 10, 1926, Clayton paid Miller & Lux $1,235,000 for the several parcels of land, which were

known as "Bloomfield" and which are referred to hereinafter as Bloomfield, for convenience. Clayton borrowed $585,000, which with the $700,000 of the Investors made up $1,285,000, the purchase price plus the Operator's $50,000 commission. Titles were taken in the name of M. E. Thomas, an employee of Clayton; notes were signed by her; and deeds of trust were given to two concerns which loaned the borrowed money. (R. 216.)

When the lands were acquired from Miller & Lux, there were leases existing which had been made by Miller & Lux, and the land was taken over subject to the leases. They yielded rents of $34,041 in 1926. (R. 216.)

During a five year period, 1926 to 1930, inclusive, 90 per cent of the property, about 24,828 acres, were sold for the total sum of $1,452,326. The loans from Miller & Lux and the Bank were paid by the end of 1927. At the end of 1930, there remained 2,672 acres, unsold. (R. 216-217.)

The depression following the "crash" of October, 1929, depressed the real estate market, generally, and the sales of the property in question fell off after 1930. During ten years, from 1930 to 1940, inclusive, the only sales were sales of 60 acres for rights of way for public services, and but for such sales, no sales would have been made in 1935, 1938, 1939, 1940 and 1942. (R. 217.)

The 42 acres in the town of Gilroy were sold in parcels making up a city block. There was never any

intention of subdividing this acreage into lots, and the Operator [Clayton] refused to sell land in units of less than one block. (R. 217.)

From the beginning, in 1926, Clayton adopted a policy of renting parcels of the acreage under leases to run for one year, subject to renewal for another year; and of keeping some of the acreage under cultivation in wheat or barley, until parcels were sold. When lands were sold, tenants were moved to other locations. The reasons for renting and cultivating the acreage, pending sales, were two-fold: To carry the taxes on the property and to keep the property from going "native," i.e., becoming overgrown with weeds and brush. The Operator paid himself a commission for renting lands. Income from farming and renting was accounted for separately on tax returns. Farming operations were carried on at a loss except in 1930, 1931, and 1934. (R. 217, 218.)

From 1926 through 1940, the operations of Clayton consisted of farming, renting, and selling property; collecting rents and payments of principal and interest on installment sales; paying taxes; disposing of produce raised on farms; and, in general, taking care of the financial and accounting aspects of the venture. (R. 218.)

During the 15-year period, 1926 through 1940, receipts of interest totalled $156,402.85; profits from sales totalled $311,766.93; gross receipts from rents totalled $456,062.91; and miscellaneous receipts totalled $19,533.97. The total of taxes for the same period was $224,722.76. (R. 218.)

Sales to and including 1940 totalled $1,474,243.06. Sales during 1941 to 1944, inclusive, totalled $352,600. The total gain over the cost of the properties, $1,285,-000, aggregates $541,843.06. (R. 218.)

Distributions totalling $98,250 have been made to each holder of the fourteen units, totalling $1,375,500, which represents return of the original $700,000 capital plus profits from all operations. (R. 218.)

When the acreage was purchased in 1926, Miller & Lux had put in nine wells and nine pumping units for pumping water. After 1931, when Clayton, and some tenants, turned to truck farming, wet farming; and when dry years reduced the level of water in the ground, Clayton put in some wells and pumps, and made some repairs to existing wells and pumps, at a total cost of $37,903, of which sum $8,267 was spent on the Miller & Lux wells and pumps. (R. 218, 219.)

There have not been any exchanges of the Bloomfield property, nor reinvestments in other property.

Frazier O. Reed, president of Clayton, managed the operations. He discussed progress with the Investors when he saw them, individually. He called them all together to meet on three occasions to discuss income tax problems. (R. 219.)

There were originally fourteen Investors and each had a one-fourteenth interest in the venture. Since 1926, changes have occurred in the Investors' interests due to deaths, transfers, and sales of all or part of a one-fourteenth interest, so that there are now nine-

teen Investors holding the original fourteen interests, some holding less than a one-fourteenth interest, and some holding a complete one-fourteenth interest plus part of another one-fourteenth interest. (R. 219.)

SPECIFICATIONS OF ERROR RELIED UPON.

1. The Tax Court erred in failing to find that the petititoners do not constitute an association taxable as a corporation.

2. The Tax Court erred in finding that the Bloomfield Ranch Syndicate is an association taxable as a corporation.

3. The Tax Court erred in holding that there are deficiencies in income tax and declared value excess profits taxes for the year 1940 in the respective amounts of $6,646.60 and $4,159.58; and erred in failing to hold that there are no deficiencies in income tax or declared value excess profits taxes for the year 1940.

4. The Tax Court erred in failing to find that each person who paid $50,000 to Clayton signed with Clayton a separate written instrument in the form of Petitioners' Exhibit 1, and that there was no other agreement by any petitioner.

5. The Tax Court erred in finding that the fourteen separate written instruments referred to in its Findings of Fact were signed by "each person who contributed to the fund of $700,000, designated as 'Investor'." (R. 213-214.)

6. The Tax Court erred in failing to find that there was no agreement by the Investors with one another.

7. The Tax Court erred in failing to find that the Investors had no meeting before they signed the respective agreements with Clayton and that some of them did not know who the others were.

8. The Tax Court erred in finding that the agreement provided that "Each investor was entitled to have returned to him the $50,000 which he advanced, in whole or in part, in the operator's judgment, but no investor was entitled to receive repayment of his contribution before the properties had been converted into cash and all charges and expenses had been fully paid".

9. The Tax Court erred in finding, with respect to said agreement "It was provided that distribution could be made in equal amounts to each investor whenever the operator had a net amount, after payment of charges, of $7,000 or more on hand."

10. The Tax Court erred in failing to find, on the contrary, that it was provided in the agreement between each investor and Clayton that upon the payment of the debts, taxes and charges accrued, any residue of money in the Operator's [Clayton] hands "shall be distributed equally to said investors whenever there shall be a net amount of $7,000 or more on hand."

11. The Tax Court erred in failing to hold that such leases as were made and such expenses as were

incurred with respect to the property after the year 1930, occurred as the result of the depression and were matters beyond the control of either the Operator or the investors.

12. The Tax Court erred in finding that from 1941 to 1944, 1112 acres were sold for $541,843.

13. The Tax Court erred in finding that the original agreement of each investor had attached to it endorsement of any assignment or transfer of all or part of a one-fourteenth interest which showed how the transfer of the interest came about or was made.

14. The Tax Court erred in holding that the fourteen instruments which were signed by the respective investors constituted a single agreement.

15. The Tax Court erred in holding that the titles to the property were not taken and held by M. E. Thomas in trust for the respective Investors.

16. The Tax Court erred in failing to hold that each respective investor was a principal and Clayton was his agent.

17. The Tax Court erred in holding that Clayton was given power to deal with the properties as though it was the sole owner, and the Tax Court erred in failing to hold that the agreement provided in the same connection that the Operator [Clayton] "may not exchange, encumber, nor lease except as above specified [for one season only], nor sell trees, wood or improvements off from said property without the consent of the investor."

18. The Tax Court erred in holding that the Investors did not have undivided interests in the lands which were purchased, and erred in holding that the Investors were not the equitable owners of undivided interests in the property acquired by the investment.

19. The Tax Court erred in failing to hold that the Investors were equitable owners of the property acquired and that their beneficial interests were not merely personal claims against the agent, Clayton.

20. The Tax Court erred in holding that the interests of the Investors were limited to rights to receive distribution of the net profits to be derived from the operation and sales of the land, and that their beneficial interests were only personal claims against the operator.

21. The Tax Court erred in holding that no investor was entitled, "as of right", to any payment or return "before said property and the proceeds thereof have been converted into cash", and all expenses, debts, charges and commissions had been fully paid; and the Tax Court erred in failing to hold, with respect to the foregoing language, that the agreement also read "provided, however, that upon the payment of the debts, taxes and charges accrued, such funds shall be distributed equally to said Investors whenever there shall be a net amount of $7,000 or more on hand."

22. The Tax Court erred in holding that liability was limited to the investment which each investor originally made in the enterprise.

23. The Tax Court erred in failing to hold that the petitioners constituted a partnership as partnership is defined by Section 3797 of the Internal Revenue Code, and Section 29.3797-4 of Regulations 111 or Section 19.3797-4 of Regulations 103.

24. The Tax Court erred in holding that "the acquisition of property for the express purpose of resale at a profit is a business undertaking"; and the Tax Court erred in holding that the purpose of the investment involved in this case was to make profits by "dealing" in real estate.

25. The Tax Court erred in holding "that those who made up a fund of $700,000 for the purchase of the Miller & Lux property constituted an association, and that respondent has correctly determined that there was an association taxable as a corporation."

26. The Tax Court erred in failing to hold that those who invested in the purchase of the Miller & Lux property did not constitute an association.

27. The Tax Court erred in holding that the petitioners constitute an association within the definition contained in Section 3797(a) of the Internal Revenue Code, so as to constitute a taxable entity taxable as a corporation.

28. The Tax Court erred in failing to hold that the petitioners do not constitute an association within the definition contained in Section 3797(a) of the Internal Revenue Code so as to constitute a taxable entity taxable as a corporation.

SUMMARY OF ARGUMENT.

Petitioners were joint venturers, owners of undivided equitable interests in real property, each of whom individually and separately appointed an agent to sell the property with such powers as were necessary to that end.

Thomas held the title in trust for each investor separately.

Each investor had a separate equitable estate in the land.

The Tax Court erred in its views as to the right of the Investors to receive their shares of the proceeds of sales and as to the interests of the Investors in the land. If it had not made these errors, it could not have concluded that the Investors did not constitute a partnership as defined in the Internal Revenue Code and that they did constitute an association doing business in the semblance of a corporation.

Clayton was an agent of each investor separately and was not a trustee.

All activities to be performed by Clayton after purchase of the property were those of an agent only.

Clayton never held the title; consequently, it could not be a trustee.

Clayton's duties are stated erroneously in the findings of the Tax Court, with consequent misinterpretation of the agreement.

The petitioners did not constitute an association.

There was nothing here analogous to a corporate board of directors and nothing that looked, even remotely like a corporation.

The case of *Gerstle v. Commissioner,* 95 Fed. (2d) 587, is decisive of the case at bar.

The petitioners were not doing business.

The cases cited by the Tax Court as determinative are distinguishable from the case at bar.

ARGUMENT.

There is no dispute about the facts. The only oral evidence was the testimony of Mr. Frazier O. Reed, President of Clayton, which is one of the petitioners. The other evidence consists of stipulations, tabulations and other documents admitted either by stipulation or without objection, all (except the return of 1940) supplied by the petitioners.

We contend that the petitioners were joint venturers, owners of undivided, equitable interests in real property, which they bought and placed in the name of Thomas. They were tenants in common and each individually and separately appointed Clayton his or her agent to sell his property, with such powers as were necessary to that end.

The Tax Court erred in finding that "the Bloomfield Ranch Syndicate is an association, taxable as a corporation". (R. 219.) Specifications 1, 2, 25, 26, 27, 28, pages 12 and 16 hereof.

The Tax Court erred in holding that there were deficiencies in income tax and declared value excess profits taxes for the year 1940. (R. 227-228.) Specification 3, page 12 hereof.

Section 3797 (a) of the Internal Revenue Code reads in part as follows:

> "* * * (2) *Partnership and Partner.* The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term 'partner' includes a member of such a syndicate, group, pool, joint venture, or organization.
>
> "(3) *Corporation.* The term 'corporation' includes associations, joint stock companies, and insurance companies."
>
> See Specification 23, page 16 hereof.

That definition of partnership first appears in the 1932 Revenue Act, Section 1111. As is said in Regulations 103, Section 19.3797-4:

> "The Internal Revenue Code *provides its own concept of a partnership.* Under the term 'partnership' it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any *business, financial operation,* or *venture* and which is not, within the meaning of the Code, a trust, estate, or a corporation. * * *" (Italics supplied.)

In reading the authorities, especially those earlier than 1932, it is necessary to keep in mind the difference between a Code partnership and a common law partnership. A Code partnership may have features incongruous with or additional to the elements of a common law partnership.

From the Code definition it is evident that carrying on a business or seeking gain or profit is not repugnant to the Code conception of partnership. Neither is such a venture or financial operation as sale of land acquired for resale at a profit.

While title to the property was for convenience taken in the name of Thomas, each of the original fourteen Investors paid for a one-fourteenth interest and so each owned an equitable undivided one-fourteenth interest in the land. Thomas was the trustee only of a resulting trust, not of an express trust, and was merely a conduit of the title.

The sole purpose of the group, as expressed in the respective agreements and confirmed by the history of the enterprise, was to buy the Bloomfield Ranch and sell it at a profit. When the Bloomfield Ranch should be sold the venture was to terminate. A continuing business was not contemplated. Capital gain, rather than recurring income, was the profit sought. Awaiting sales, of course, the land had to be kept in good and salable condition, and, to do that, cultivation by the management or by tenants was necessary. Moreover, prudent management required that as much incidental income as possible be earned by the land unsold in order to meet taxes and other ex-

penses. A group that buys an apartment house or office building for the purpose of selling it at a profit does not change the character or purpose of its activity merely by trying to fill the building with good tenants and make it profitable and salable while awaiting a buyer. The depression prolonged the activity of the petitioners, but did not alter their original purpose of selling as soon as buyers could be found at the prices set.

Though the agreement signed by each investor and Clayton contained no provision for transfer of interests, the law recognizes the right of each owner to transfer his property interest in the absence of agreement to the contrary. On his death such interest passed by succession or will. The title had to lodge somewhere. But in this case such interests were not *readily* or conveniently transferable in the way of shares of corporate stock. Though some transfers of interest occurred, none of them released the original investor from any obligation. Clayton was not a party to any transfer of interest. It accepted notice in each instance and acknowledged receipt.

The group had no resemblance to a corporation. No "association" was formed. Each investor, separately, was a principal and Clayton was his agent. The name "Bloomfield Ranch" was only a name of convenience and had no significance with respect to organization as an association or corporation. It was adopted because Miller & Lux objected to the use of their name in connection with sales. (R. 79, 80.) No meetings were held such as corporations hold. There

was no committee resembling a board of directors; there was no organization at all. No entity intervened between the respective investors and the purchasers of the property. Furthermore, there was no intent or plan that such an entity should come into being. (R. 74-76.) That our position is not unreasonable is shown by the fact that for many years the Commissioner took the same position respecting the Bloomfield Ranch. In 1926 Clayton sent a representative to San Francisco to ascertain how the Bloomfield Ranch income tax returns should be filed. He obtained the information and the returns were filed that way until 1930. In 1930 the matter was reviewed and the percentage of cost and the percentage of profits of sales was agreed upon and after that returns were filed as before without any question until the present question regarding the return for 1940 was presented. (R. 119.)

The Tax Court said in its opinion (R. 224):

> "Titles were originally taken and held by the Operator in the name of M. E. Thomas, and no change was ever made. The titles were not held by M. E. Thomas in trust."

This we have specified as error. (Specification 15, page 14 hereof.)

State laws of property such as that declaring that one is a trustee who takes the title to property which is paid for by another, and such as that providing that a trustee must have title to the property held in trust, are binding upon the Federal Courts.

> *Edward Hines Yellow Pine Trustees v. Martin,* 268 U. S. 458, 69 L. Ed. 1050;

Warburton v. White, 176 U. S. 484, 44 L. Ed. 555;

Clarke v. Clarke, 178 U. S. 186, 44 L. Ed. 1028.

THOMAS HELD THE TITLE IN TRUST FOR EACH INVESTOR SEPARATELY.

As we have seen, each of the fourteen Investors contributed $50,000 to the purchase of the property (the remainder of the purchase price having been borrowed and later repaid) and title was taken in the name of M. E. Thomas.

The *Civil Code of California*, Section 853, provides:

> "When a transfer of real property is made to one person, and the consideration therefor is paid by or for another, a trust is presumed to result in favor of the person by or for whom such payment is made."

It seems too plain for argument, that, when each investor paid $50,000 toward the purchase of the property, and caused title to be taken in the name of Thomas, a trust resulted in favor of each investor and the titles were held by Thomas in trust.

See

Estate of Harris, 9 Cal. (2d) 649, page 660, 72 Pac. (2d) 873,

where it is said:

> "It is elementary, however, that if the consideration for the purchase of any property is furnished by a stranger to the title, the holder of the

title, by operation of law, holds the title in trust for the one who furnished the consideration."

Harris v. Cassells, 202 Cal. 648, 262 Pac. 319;
Riley v. Martinelli, 97 Cal. 575, 32 Pac. 579;
Case v. Codding, 38 Cal. 191;
Currey v. Allen, 34 Cal. 254.

EACH INVESTOR HAD A SEPARATE EQUITABLE ESTATE IN THE LAND.

The Tax Court erred in holding that the Investors did not have undivided interests in the lands which were purchased, and that they were not the equitable owners of the property. (R. 224.) (Specifications 18, 19, page 15 hereof.)

After stating that the titles were not held by Thomas in trust, the opinion of the Tax Court continues (R. 224):

> "Furthermore, the fourteen Investors were not given any undivided interests in the realty which was purchased."

The Investors bought and paid for the property. They caused title to be conveyed to Thomas. They held undivided equitable interests in the property which must be regarded as the real ownership, the legal estate held by Thomas being no more than "the shadow" following the equitable estate, as said in the *Duffill* case, *infra.*

In

Title Ins. & Trust Co. v. Duffill, 191 Cal. 629, 218 Pac. 14,

it is said, pages 647, 648:

"The generally accepted rule in this country also is that 'under the system now prevailing the *cestui que trust* is regarded as the real owner of the property, the trustee being merely the depositary of the legal title. His is not a property right, but a legal duty founded upon a personal confidence; his estate is not that which can be enjoyed, but a power that can be exercised.' (39 Cyc. 203.) Such estates 'are in equity what legal estates are in law; the ownership of the equitable estate is regarded by equity as the real ownership, and the legal estate is, as has been said, no more than the shadow always following the equitable estate, which is the substance, except where there is a purchaser for value and without notice who has acquired the legal estate.' "

In

Watson v. Sutro, 86 Cal. 500, 24 Pac. 172, 25 Pac. 64,

the Court held that Baird held an undivided interest in the title to certain lands for Watson. Baird conveyed to Sutro who, the Court held, took with notice of Watson's right. Watson sued for partition of the property. His right to partition was sustained.

Capuccio v. Caire, 189 Cal. 514, 209 Pac. 367.

Capuccio was a stockholder in a corporation which forfeited its charter for failure to pay its license tax. The Court, assuming that the former directors held title as trustees for the stockholders, sustained the right of Capuccio, as owner of the equitable title, to maintain a suit for partition.

It follows that each investor was the equitable owner of an undivided 1/14 interest in the land and

hence of the proceeds of the sales. This, no doubt, is why the agreement provided (R. 169) that the funds should be distributed whenever there was on hand $7,000 net or more. In other words, $500 for each of the 14 investors.

Indeed the Board of Tax Appeals, in the *Huron* case, 44 B.T.A. 859, 863, said,

> "* * * in the *Gerstle* case, which was held to be a joint venture, 'it seems clear that the members were equitable owners of the property acquired'."

An equitable title in land is real property.

> *Murphy v. Crowley,* 140 Cal. 141, 73 Pac. 820;
> *Title Insurance & Trust Co. v. Duffill,* 191 Cal. 629, *supra.*

THE TAX COURT ERRED IN ITS VIEWS AS TO THE RIGHT OF THE INVESTORS TO RECEIVE THEIR SHARES OF THE PROCEEDS OF SALES AND AS TO THE INTERESTS OF THE INVESTORS IN THE LAND. IF IT HAD NOT MADE THESE ERRORS, IT COULD NOT HAVE CONCLUDED THAT THE INVESTORS DID NOT CONSTITUTE A PARTNERSHIP AS DEFINED IN THE INTERNAL REVENUE CODE AND THAT THEY DID CONSTITUTE AN ASSOCIATION DOING BUSINESS IN THE SEMBLANCE OF A CORPORATION.

The opinion of the Tax Court continues (R. 224):

> "They [the Investors] were given only the right to receive 'moneys remaining in the Operator's hands' after paying all costs, obligations and expenses; they were given the right only to have returned to them, at the same time, in equal amounts, the whole or part of the sum receipted for in each instrument; and no Investor was entitled, '*as of right*' to any payment or return 'be-

> fore said properties and the proceeds thereof have been converted into cash,' and all expenses, debts, charges, and commissions had been fully paid." (Italics supplied.)

These statements are in error. (Specifications 20, 21, page 15 hereof.)

The owners were entitled to equal distribution whenever there was a net amount of $7,000 on hand, and that right was reserved to them by a proviso in the same paragraph of the agreement where the Court found the expression that it quoted *"as of right"*, etc. (R. 169.)

The view of the Tax Court that the investors were not *"given"* interests in the property which they had bought and paid for and which they owned, and that they were *"given"* only the right to receive moneys from the operator's hands, proceeds of property that they owned, illustrates why the errors that we discuss appear in the opinion and in the findings. As was said by Mr. Justice Holmes in *Guy v. Donald,* 203 U. S. 399, page 406, 51 L. Ed. page 247:

> "As long as the matter to be considered is debated in artificial terms there is a danger of being led by a technical definition to apply a certain name, and then to deduce consequences which have no relation to the grounds on which the name was applied."

The opinion of the Tax Court continues:

> "From the terms of the instruments it must be concluded that the interests of the Investors were limited to rights to receive distribution of the

> net profits to be derived from the operation and sales of the land; and that their beneficial interests were only personal claims against the Operator; and that the Investors did not have interests in the land itself." (R. 224, 225.)

That statement is in error. (Specifications 15, 18, 19, 20, pages 14 and 15 hereof.)

The Investors were not limited to rights to receive net profits, but each had his right also to receive his share of the proceeds of the sales as they were made whenever $7,000 was available. As we have seen the interests of the Investors were real property, and not merely personal claims against the operator.

If the Tax Court had not made that error it could not have found that the Investors did not constitute a partnership, as defined in the Code section, and did constitute an association doing business in semblance of a corporation.

These erroneous views of the Tax Court led it to say (R. 225):

> "The nature of interests of the Investors serves to distinguish this case from the Gerstle case where it was held that individuals were joint ventures (sic) and the Circuit Court concluded that they were 'equitable owners of the property acquired, and that their beneficial interests were not merely personal claims against the syndicate managers.' "

On the contrary, as to the title, the *Gerstle* case and the case at bar are on all fours.

In *Commissioner v. Gerstle*, 95 Fed. (2d) 587 (C.C.A. 9, 1938), the title to all the properties that were acquired was taken in the name of one or the other of two title companies (as here the title was taken in the name of Thomas). And this Court said (at p. 590):

> "It seems clear that the members were equitable owners of the real property acquired, and that their beneficial interests were not merely personal claims against the syndicate managers."

CLAYTON WAS AN AGENT OF EACH INVESTOR SEPARATELY AND WAS NOT A TRUSTEE.

(Specification 14, page 14 hereof.)

The agreement designates Clayton throughout as "Operator" (R. 167-170), which, like manager, appropriately designates an agent with broad powers. *Commissioner v. Whitcomb*, 95 Fed. (2d) 596, page 598. The agreement nowhere refers to Clayton as trustee. The Tax Court did not find and did not hold in its opinion that Clayton was a trustee.

Each Investor, by the terms of his agreement with Clayton, provided that the "Operator", Clayton, was to use the $50,000 received from the Investor, together with other sums contributed by thirteen other persons, and other sums borrowed, in the purchase of the Miller & Lux lands, as described in three deeds to M. E. Thomas, dated March 3, 1926, and to take and hold title to the properties in the name of Thomas. (R. 167.)

To put it briefly, each Investor said to Clayton, "Take my $50,000 and with similar sums from thirteen others and money that you are to borrow, buy the Miller & Lux lands and take and hold the title in the name of Thomas." This Clayton did, and in doing so was, of course, merely an agent, not of a group (for there was no agreement with the group) but of each individual separately.

The agreement then provides that the Operator

> "* * * may take such title in the name of any other person, corporation or concern, or in its own name; and may have such title conveyed, from time to time, to other persons, corporations or concerns, or otherwise conveyed or held, as the Operator may desire, in trust for the said 14 investors above referred to, *for the profitable resale thereof.*" (R. 167, 168; Italics supplied.)

Title was taken in the name of Thomas, and was conveyed by Thomas from time to time, as buyers were found. No other change in the title has ever been made. The Tax Court said:

> "Petitioners contend that they were owners of undivided interests in real property, who had appointed an agent to sell the property, and that while titles were taken in the name of M. E. Thomas, she was only a trustee of a resulting trust." (R. 224.)

That is a correct statement of our position; but the Tax Court further said,

> "It appears that petitioners advance the argument here that Clayton Company was a trustee-manager for each Investor." (R. 225.)

We make no such contention. We assert that Clayton was agent for each respective Investor, and nothing more.

All activities to be performed by Clayton after purchase of the property, were those of an agent only.

When the title was transferred to Thomas, all that remained for Clayton to do was to make profitable sale of the property, with incidental care of it in the meantime. That, of course, was a pure matter of agency.

To that end the agreement next provides (R. 168) that:

> "The Operator [Clayton] may sell, convey, hold, lease for one season only, or in any otherwise deal with and treat said properties as the sole and absolute owner thereof in fee simple, and without let or hindrance from the Investor, or any of the Investors, less than the full number thereof, or any other person or concern, whatsoever."

It is significant that while the opinion of the Tax Court states (R. 221) that the Operator was given power "to deal with the properties as though it was the sole owner * * *" the Court omitted to mention in that connection the next sentence in the agreement which reads (Specification 17):

> "*But may not exchange, encumber, nor lease except as above specified, nor sell trees, wood or improvements off from said property without the consent of the Investors.*" (R. 168; Italics supplied.)

The words of the agreement: "or in any otherwise deal with and treat said properties as the sole and absolute owner thereof * * * etc." must be read with, and are limited by, the other terms of the agreement, having in mind that the whole purpose of the venture was the purchase and profitable resale of the property. Having no power to exchange, encumber, or lease except for one season only, the agent's only power was to sell, meanwhile doing what was proper to protect the properties. This is further shown by the provision of the agreement giving Clayton power to incur costs, expenses and charges "in connection with the acquiring, holding, renting, selling or protecting of said properties," (R. 168).

The *Civil Code of California,* Section 2321 provides:

> "When an authority is given partly in general and partly in specific terms, the general authority gives no higher powers than those specifically mentioned."

Clayton was required to keep books of account showing all moneys paid out, sales made, properties disposed of and moneys received (R. 168); a provision quite appropriate for instructions to an agent.

When Clayton found a buyer, Thomas made the deed. The effect was the same as if Thomas had held the power of attorney of each Investor and signed the deeds as attorney in fact. Thomas was merely a conduit of the title.

The equitable title to the property (the substance) was in the petitioners, Thomas had the legal title (the shadow); Clayton, the agent, made the sales.

In *Lewis & Co. v. Commissioner,* 301 U. S. 385, 81 L. Ed. 1174 (May 17, 1937), the grantor placed title in a trust company as trustee for herself and Lewis as beneficiaries. Lewis was authorized to exercise management and control of the property for the purpose of sale. Title was to be conveyed by the trustee to purchasers upon Lewis' directions. This was like the case at bar.

The Court described the situation and its legal effects as follows (81 L. Ed. 1175-6):

> "If it were not for the declaration of trust. we should have here the simple case of an appointment by a land owner of an agent to subdivide the land and sell it, receiving as compensation for his services a fixed percentage of the payments made by the purchasers. It is quite evident that such an arrangement has no element of substance or method which would warrant its designation as an association under the statutory provision in question. Nor can we see that the intervention of a trustee to hold title, execute contracts and conveyances at the direction of the real-estate agent and make collections alters the situation." * * *
>
> "There is to be found in the operation of the business no essential characteristic of corporate control—nothing analogous to a board of directors or shareholders, no exemption from personal liability, no issue of transferable certificates of interest. There is simply the common relation of

principal and agent, coupled with the collateral incidents of an ordinary trust."

In *Kilgallon v. Commissioner* (C.C.A. 7, 1938), 96 F. (2d) 337, the Court said of the *Lewis* case (p. 340):

> "We think that petitioners are correct in their contention that merely increasing the number of principals and utilizing the device of an agent to represent all the principals would not create an 'association' within the meaning of the term as used in Section 701(a)(2). Such an arrangement would in all probability be a partnership, even though the agent's powers might be so extensive that the partnership would have all the advantages, during the continuance of the agency relationship, of centralized management."

Clayton never held the title; consequently, it could not be a trustee.

It is the law of California that to create an express trust there must be a transfer of the property to the trustee.

The *Civil Code of California*, Sec. 852, provides:

> "*Trust must be in writing.* No trust in relation to real property is valid unless created or declared:
>
> 1. By a written instrument, subscribed by the trustee, or by his agent thereto authorized in writing;
>
> 2. By the instrument under which the trustee claims the estate affected; or,
>
> 3. By operation of law."

In *Bainbridge v. Stoner,* 16 Cal. (2d) 423, page 428; 106 Pac. (2d) 423, it is said:

> "To create an express trust there must be an explicit declaration of trust followed by an actual conveyance or transfer of property to the trustee."

In *Nichols v. Emery,* 109 Cal. 323, page 330; 41 Pac. 1089, the Court said:

> "* * * to the creation of a valid express trust it is essential that some estate or interest should be conveyed to the trustee, and, when the instrument creating the trust is other than a will, that estate or interest must pass immediately."

See also I. T. 1585, C. B. II-1, page 4, where the Income Tax Unit of the Bureau of Internal Revenue held that where an agent did not hold the legal title, no trust was created.

CLAYTON'S DUTIES ARE STATED ERRONEOUSLY IN THE FINDINGS OF THE TAX COURT, WITH CONSEQUENT MISINTERPRETATION OF THE AGREEMENT.

The Tax Court, in its findings, purports to set forth briefly the purpose and terms of the agreements. That summarization is not binding upon this Court for the reason that the instruments of agreement are incorporated in the findings by reference. (R. 214.) Since the findings below referred to are not in accordance with the terms of the agreements, they must be disregarded. The Tax Court found, in paragraph 4 relating to the agreement (R. 215), that

> "Each investor was entitled to have returned to him the $50,000 which he advanced, in whole or in part, in the Operator's judgment, but no Investor was entitled to receive repayment of his contribution before the properties have been converted into cash and all charges and expenses had been fully paid."

Also (R. 215), that

> "It was provided that distribution *could* (italics ours) be made in equal amounts to each Investor whenever the Operator had a net amount, after payment of charges, of $7,000 or more on hand."

These findings are erroneous.

(Specifications 8, 9, and 10.)

At the expense of a brief duplication, we repeat, with italics supplied, a paragraph of the agreements (R. 169) so that the Court may see the effect of this misinterpretation.

> "From any residue of moneys remaining in the Operator's hands, after all the foregoing payments have been made, the Investor shall be entitled to have returned to him, at the same time, and in equal amounts, as are returned to the other Investors, *the whole or such part* of the said sum herein receipted for, as may, in the judgment of the Operator, be safely paid, without jeopardy to any remaining properties or assets, not yet converted into cash; but no Investor shall be entitled, as of right, to any payment or return, or repayment before said properties and the proceeds thereof, have been converted into cash, and all such commissions, debts, advances, costs, charges and expenses have been fully paid, *provided, how-*

ever, that upon the payment of the debts, taxes and charges accrued, such funds shall be distributed equally to said Investors whenever there shall be a net amount of $7,000 or more on hand." (R. 169.) (Italics supplied.)

The error in stating in the finding the provision that we have italicized makes it appear that distribution of the fund was permissive rather than mandatory, i.e., that distribution *could* be made instead of *must* be made. The finding thus gives the erroneous impression that distribution of the funds whenever there was a net amount of $7,000 on hand was a matter in the discretion of the Operator, and hence was something like the distribution of dividends of a corporation to stockholders. But the contrary was the fact, as shown by the provision in italics, *supra,* that the funds "*shall be distributed* whenever there shall be a net amount of $7,000 or more on hand". The Operator had no discretion. This mandatory provision is, of course, peculiarly appropriate to directions by an owner to an agent, and has no resemblance to the methods of distribution by a corporation. This is not only the instruction of the investor to his agent, but, it is the agreement of the agent to comply. There is no intervening entity controlling the fund.

The agreement further provides for payment by *the Operator to the Investors*, in equal shares, of the net proceeds when all the properties were converted into cash. (R. 169, 170.) The language is "* * * *shall* be, by said Operator paid to and divided among the Investors, in equal shares to each of them, * * *".

Thus there are two provisions in the agreements for payments to the Investors; *one,* whenever there was $7,000 available; *the other,* when all the properties were sold. Both are mandatory and both require payment to each investor individually. Besides each investor is entitled to an account of all transactions rendered to him by the Operator on demand not more often than once each sixty days. (R. 170.)

THE PETITIONERS DID NOT CONSTITUTE AN ASSOCIATION.

(Specifications of Error Nos. 1 and 2, page 12 hereof.)

The Tax Court erred in finding that the fourteen separate written instruments were signed by each person who contributed to the fund of $700,000 (R. 215), (Specification 5, page 12 hereof), and in failing to find that each person who paid $50,000 to Clayton signed a separate agreement and that there was no other agreement. (R. 51, 53) (Specification 4, page 12 hereof.) It also erred in failiing to find that there was no agreement by the Investors with one another and that they had no meeting before they signed the agreements and that some of them did not know who the others were. (R. 50, 103, 104.) (Specifications 6 and 7, page 13 hereof.) There is no conflict in the evidence on these points. (R. 50, 53, 100, 104.)

The Investors were co-tenants. In *Burnet v. Burns,* (C.C.A. 8, 1933), 63 Fed. (2d) 313, Burns owned a half interest in a lease, the other half of which was owned

by a syndicate. The Government contended that since the trustees for the syndicate acted both for the members of the syndicate and also for Burns, it must be held that Burns was a member of the syndicate. The Court said (p. 316):

> "Certainly one who is a cotenant of a corporation or an association does not render himself liable to pay taxes as a corporation because he permits his cotenant to manage his property and account to him for his share of the profits."

We have already shown that the Investors were owners of the equitable title to the lands they bought. They were co-tenants. They had no agreement with one another.

C. H. Clovis, 32 B.T.A. 646, resembles the case at bar. The Board in that case quoted from the *Burns* case, at page 657, the language that we have set forth above and on page 653 in describing the Clovis situation used language particularly apposite to the case at bar as follows:

> "By the agreement the individuals became tenants in common in their ownership of the property and, so far as the record discloses, continued in such relationship without doing anything further to transfer the legal title to the trustees. *If the agreement, considered together with the predecessor agreements of trust, should be deemed sufficient to vest legal title in the trustees, our holding would have to be that the trustees merely held bare legal title for the tenants in common as a mere convenience, they retaining the beneficial title as tenants in common.* Obviously it would have been cumbersome and impractical to execute

a conveyance to each co-owner of his share of the property. * * * In either event they actually conducted the enterprise, not through an organization, but through an agent, C. E. Clovis. *Some semblance of organization is necessary to result in an association.*" (Italics supplied.)

In *Commissioner v. Rector & Davidson* (C.C.A. 5, 1940), 111 Fed. (2d) 332, four individuals purchased an interest in a mineral lease and vested title to the lease in two of them. The name of Rector & Davidson was assigned to identify the venture. Fractional parts were sold to various individuals; Rector & Davidson were authorized to execute all instruments, control, manage and operate the lease, collect the proceeds, pay all proper expenses and distribute to the owners their proportionate shares of the net proceeds. The Court said (p. 333):

> "In the case before us the title was held in undivided interests by all of the participants, and they were tenants in common of realty. Centralized management was obtained, not by shareholders' votes, but by the creation of an agency relation by each co-owner as principal, and without provision for continuity. There was no limitation of personal liability. No stock was issued, no meetings were held, and the enterprise had no office, no seal, no minutes, and no stock books; nor was any trust ever created. In these circumstances, the finding of the Board of Tax Appeals that respondent was a syndicate or joint venture which resembled a partnership more nearly that it did a corporation was a fair and reasonable conclusion, supported by the evidence, and its decision should be affirmed."

There was nothing here analogous to a corporate board of directors, and nothing that looked, even remotely, like a corporation.

The Tax Court erred in holding that the fourteen instruments (separately signed by the respective Investors) constituted a single agreement. (R. 223.) (Specification 14, p. 14 hereof.) There was no interrelation between the Investors. They invested in a common property; but they had no agreement with one another. Some of them do not know the others. (R. 50.) Each invested but $50,000 and each by his agreement dealt separately and individually with Clayton only. No investor could have given, and none purported to give, Clayton any instruction as to how Clayton was to deal with the other Investors.

In *McKean v. Scofield* (C.C.A. 5, 1940), 108 F. (2d) 764, where there were several trusts confided to the same trustees, the Court said at page 765:

> "That the trusts cover undivided interests in the same properties, that they have the same trustees and identical powers and similar limitations, and that in practice the trustees have dealt with all alike, keeping but one set of books, does not amalgamate or consolidate the trusts or make them one for tax purposes. It was so held even when several such trusts were all created by one grantor and in a single instrument in *United States Trust Co. v. Commissioner,* 296 U. S. 481, 56 S. Ct. 329, 80 L. Ed. 340, and *Helvering v. McIlvaine,* 296 U. S. 488, 56 S. Ct. 332, 80 L. Ed. 345, affirming 7 Cir., 78 F. 2d 787, 102 A.L.R. 252." * * *
>
> "Nothing in the law, nothing in the trust deeds binds the trusts together, and the fact that the

> trustees are the same persons and the property undivided estates in the same realty is not enough. In law the trustees are as separate as though they were different individuals. There has been co-operation between the trusts, but no incorporation."

The Tax Court seemed to think that because Clayton is a corporation, there was thus a provision for a successor for the purpose of holding title and the death of individual participants would not cause any change in the "constitution of the venture". We see no point in this. It would follow that if two co-tenants separately appointed a corporation as their respective agent to sell their property, they would constitute an association. That cannot be the law and the authorities herein so show. To stress the mere fact that the Investors had as their common agent a corporation omits the idea that there must be some organization or body of persons whose control, direction and participation in the conduct of the enterprise bear some resemblance to a corporation. Here we have nothing of that kind. The case is like that of *C. A. Everts et al. v. Commissioner,* 38 B.T.A. 1039 (1938). There Everts sold to various persons fractional interests in an oil and gas lease. Each assignee appointed Everts his agent to act for him in caring for and marketing the oil and gas obtained from the properties. The Board held that there was no association and said, at page 1050:

> "In the instant case we have, without doubt, a business enterprise, but we do not have a business trust with corporate attributes as was con-

> sidered in the *Morrissey* and its companion cases. Therefore, to find that the petitioners constituted 'associations' taxable as corporations there must be found to exist here some organization or body of persons whose control, direction, and participation in the conduct of that business enterprise bear corporate analogy."

The following language from the *Everts* case (at p. 1050) strikingly describes the situation in the case at bar:

> "It is true that each coowner, as such, was necessarily interested in the business enterprise of drilling wells on the Jamison lease and producing oil and gas therefrom for profit. *However, they had no agreement or arrangement among themselves as a group, providing for the essential characteristics of corporate control of the enterprise. They achieved a unity of purpose and operation only through having a common agent. There was nothing analogous to a corporate board of directors with broad powers to manage, direct, and control the enterprise. Instead each coowner, separately and individually, appointed Everts his or her agent with powers and authority expressly delegated and fixed in advance by his or her individual agreement with Everts. There was nothing analogous to corporate shareholders owning transferable certificates of interest. Instead each party in interest was the owner of an undivided interest in real property, which was transferable only as real property.*" (Italics supplied.)

In *Commissioner v. Whitcomb, etc.* (C.C.A. 5, 1938), 95 Fed. (2d) 596, 65 individuals and companies

signed an agreement with each other and with Whitcomb, called manager, which stated that they desired to and did thereby form a syndicate for the purpose of buying and selling shares of the common stock of Coca-Cola Company. The Court affirmed a decision of the Board of Tax Appeals which held that there was no entity to be taxed as a corporation. The Court said, at page 598:

> "The manager was not the agent of an aggregation of subscribers, that is to say, of an entity, but the authority was expressly to buy and sell the stock 'for the account of each subscriber'. * * *"

The agreements recognize the separate interest that each investor had in the land; for payments were to be made by Clayton to each investor separately, not to the group; and not to Thomas, in whose name the legal title stood; also, each separate investor was entitled to have an account rendered *to him* (not to the group). All transactions between each investor and Clayton were on an individual and not a group basis. Each investor separately paid his money to Clayton for the purchase of the property, each signed a separate agreement with Clayton, funds when available were payable to each investor separately, and accounts were required to be rendered to each investor separately.

In *American Cities Power & Light Corp.*, 38 B.T.A. 74 (1938), companies interested in certain stocks, formed what they called "stock trading accounts" under which stocks were to be bought and sold by

a designated manager for the account of each of the participants, none of whom the agreement provided should be liable for the obligations of the others. The petitioners contended that they were agents of the holders of the participating interests in accounts and that the accounts were not associations. Their contention was sustained by the Board, which said (at p. 81):

> "The arrangement in each of the accounts is less like a corporation than that in *Commissioner v. Whitcomb, etc.*, 95 Fed. (2d) 596; *Commissioner v. Gerstle*, 95 Fed. (2d) 587; *Darol Trading Account*, 34 B.T.A. 837."

In *Stantex Petroleum Co., Trustee*, 38 B.T.A. 269 (1938), the Petroleum Company sold undivided interests of an oil and gas lease and agreed to drill a well at its own expense. As agent for the holders of undivided interests, it sold the output of the wells, and distributed the net proceeds to the lease holders. The Board said (at p. 272):

> "Exclusive of the amount collected for itself, such income as was derived from the wells was collected by the Stantex Petroleum Co. as agent or trustee for its co-tenants. See *Commissioner v. Whitcomb-Coca Cola Syndicate;* 95 Fed. (2d) 596; *Mark L. Gerstle*, 33 B.T.A. 830; affd., 95 Fed. (2d) 857."

THE CASE OF GERSTLE v. COMMISSIONER (C.C.A. 9, 1938), 95 FED. (2d) 597, IS DECISIVE OF THE CASE AT BAR.

The syndicates there involved were held not to be taxable as corporations.

The Tax Court said, in its opinion in the case at bar (R. 225):

> "The nature of interests of the Investors serves to distinguish this case from the Gerstle case where it was held that the individuals were joint ventures (sic), and the Circuit Court concluded that they were 'equitable owners of the property acquired, and that their beneficial interests were not merely personal claims against the syndicate managers'."

As in the *Everts* case *supra,* the Investors here achieved unity of action only by having a common agent.

If we parallel certain similarities of and differences between the *Gerstle* case and the case at bar, it will be seen that the Gerstle Syndicates more closely resembled a corporation than do the Investors in the case at bar.

1. In the *Gerstle* case the members of one syndicate contributed to a pool using the aggregate amount to purchase certain properties which they believed could be quickly resold at a profit. The management of the properties was intended to be such only as would be necessarily incident to the ownership during the interim between purchase and sale.[1]

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[1]*Gerstle*, 33 B.T.A. 830, at p. 832: "The members of the first syndicate * * * decided to contribute to a pool, using the aggre-

In the case at bar there was no concerted action of the Investors, each of whom dealt with Clayton separately, but the purpose and intention were the same as those of the syndicate members in the *Gerstle* case.

2. In the *Gerstle* case the one agreement was signed by all the parties, thus making the transaction more like an association than in the case at bar where there was no common agreement. (R. 53.)

3. The *Gerstle* agreement gave the syndicate managers complete discretion in the selection of the properties to be purchased, the amount of purchase price, details of management, terms of sale and all other matters related to syndicate operations.[2]

In the case at bar specifically designated property was to be bought, and sold, and Clayton (with narrower powers than those given the Gerstle managers) was appointed agent for that purpose by each investor individually and separately.

4. In the *Gerstle* case it was provided that the title to properties purchased might be taken in any

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gate amount for the purposes of purchasing the properties thereafter acquired. At the outset it was their purpose and intention to purchase certain properties which they believed could be quickly resold at a profit and distribute the profits proportionately among the members. * * * The management of the properties and the collection of rents and payment of taxes, interest, etc., was intended to be such only as would be necessarily incident to the ownership in the interim between the purchase and expected sale."

[2]*Gerstle*, 33 B.T.A. 830, at page 832: "The Syndicate Managers * * * shall have complete discretion in the selection of the properties to be purchased, the amount of the purchase price, the details of management, the terms of sale and of mortgage, and of all other matters related to the Syndicate operations."

name or names the Syndicate Managers determined and title was held by two Title Companies.[3]

In the case at bar it was specifically provided that title be taken originally in the name of M. E. Thomas and, as stated in the opinion of the Tax Court (R. 224):

> "Titles were originally taken and held by the Operator in the name of M. E. Thomas, and no change was ever made."

5. In the *Gerstle* case the Board said that after the several ventures were launched, it appeared that the peak of real estate values had been reached, the market declined and the expected prompt profitable resale of the properties became impossible. This situation forced the Gerstle Syndicates Managers to undertake certain activities not contemplated by the original plan, such as the demolishing of buildings.[4]

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[3]*Gerstle*, 33 B.T.A. 830, at page 832: "The properties purchased may be taken in any name or names that the Syndicate Managers may determine."

[4]*Gerstle*, 33 B.T.A. 830, at page 834: "After the syndicates were launched on their several ventures and had acquired their various properties, it appeared that the peak of value had been reached in the real estate market in the city of Oakland. The expected increase in value failed to materialize. On the contrary, the market suffered a decided decline, which continued throughout the years in question and later. By reason of these circumstances the expected prompt profitable resale of the properties became impossible." And at page 838: "No opportunity for sale presenting itself and it appearing to the syndicate members that because of the depression then existing no such sale could reasonably be expected, the buildings were demolished on February 28, 1929, the members at that time believing that they could dispose of the holding more readily if they were in a position to sell the land either as a unit or in parcels carved therefrom."

So also in the case at bar the depression in real estate values stopped immediate sale and required the continued operation of the properties. (R. 140, 209.) See Specification 11, pages 13-14 hereof. However, the operations of the Gerstle Managers went further than those of Clayton in the case at bar. The mere fact that there were more properties in the case at bar and consequently more time was required to sell them, makes no difference in principle.

6. In the *Gerstle* case the syndicates as such had no name, no office, except as that of the fiscal agent could be so considered, no officers except as the managers could be so considered, no stationery, no by-laws, no books of record except accounts kept by the fiscal agent.[5]

The Investors here as such had no common name, no office and no officers; certainly Clayton as the agent for the individual Investors could not be so considered; they had no stationery, no by-laws and no books of record. The account kept by Clayton was the same form of account that Clayton keeps in any case where it is acting as agent. (R. 74, 75, 76, 77, 80.)

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[5]*Gerstle*, 33 B.T.A. 830, at page 835: "The syndicates, as such, had no name; no office, except in so far as the office of the American Trust Co., as fiscal agent of the syndicates, could be so considered; no officers, save in so far as the syndicate managers could be so considered; no stationery; and no bylaws or other regulatory rules, save as the same may be contained in the several syndicate agreements. No stated meetings were provided for or held; no books of record of any kind were kept by the syndicates as such, except those kept for their account by the fiscal agent; no issue of capital stock or other similar evidence of beneficial interest was provided for or ever issued. The agreements provided the sole evidence of the interest of the several members, and each member received an executed counterpart thereof. Except for the agreements, there was no formal organization."

7. In the *Gerstle* case, there was no capital stock nor certificates of beneficial interest and the agreements provided the sole evidence of the interest of the several members and except for the agreement (executed by all members) there was no formal organization.[6]

In the case at bar there was no capital stock nor were there certificates of beneficial interest. The agreements executed separately and individually by each investor and Clayton did not even provide for the informal organization inferentially found in the *Gerstle* case. Thus the Gerstle Syndicates more closely resembled corporations.

8. The members of the Gerstle Syndicates informally met and discussed syndicate affairs and policies.[7]

In the case at bar the Investors never met except in two or three instances when some of them met to discuss tax matters. (R. 76.)

9. In the *Gerstle* case it was said (33 B. T. A. 830) that the only persons who might be said to stand in

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[6]See note 5, *supra*.

[7]*Gerstle*, 33 B.T.A. 830, at pages 835, 836: "The affairs of the syndicate were discussed informally by the members. On the occasional meetings of the directorate of the Emporium or the Emporium Capwell Corporation and on such other occasions as they happened to meet, the several members of the syndicates consulted with each other concerning the policies to be pursued at any given time. While the agreements gave to the syndicate managers broad and exclusive powers, the practice was to decide all questions of importance only after the views of all concerned had been obtained. These views were obtained either on the occasions of the meetings of the members in their capacity as directors referred to, or by telephonic communication between the various members of the syndicates referred to, or on any other occasion when they happened to meet, either in a business or social way * * *."

the position of officers or directors were the managers, and they did not act as such.

The case at bar is even less like a corporation; there were no officers nor directors.

10. In the *Gerstle* case neither the managers nor any member held legal title to any of the syndicate real estate, title was held by two title companies.[8]

In the case at bar the legal title was held by Thomas.

11. In the *Gerstle* case the syndicates were not organized with the idea of remaining in existence any substantial length of time nor of actively operating any business. Nor was it intended to improve the properties. Management was to be only such as was necessary and incident to ownership during the interim between purchase and sale. (33 B.T.A. 830, p. 840.)

The same is true in the case at bar. It is true that it involved much more property, which, as pointed out in the opinion of the Tax Court, required a longer time to sell. The principal delay, however, was caused by the depression, with the result that during a period of ten years, from 1930 to 1940, there were virtually no sales, and during that time, of course, the unsold properties required care, including renting or farming. At no time was the original purpose of the profitable resale of the properties changed. (R. 87.)

The Board, using the following language held the Gertsle syndicates not taxable as associations (33 B.T.A. at page 840):

[8] *Gerstle,* 33 B.T.A. 830.

"We conclude that the syndicates were not associations taxable as corporations. See *The Highlands, etc., Trust No. 1546,* 32 B.T.A. 760.

"The syndicates here involved meet the tests of the definition of joint ventures. A joint venture is 'a special combination of two or more persons, where, in some specific venture, a profit is jointly sought, without actual partnership or corporate designation.' *Bowmaster v. Carroll,* 23 Fed. (2d) 825; *Motter v. Smyth,* 77 Fed. (2d) 77. Property acquired by participants in a joint venture for the purposes of the venture is the property of the participants, *McCausey v. Burnet,* 50 Fed. (2d) 491; as tenants in common, *Clark v. Sidway,* 142 U.S. 682."

This Court, affirming the ruling of the Board of Tax Appeals in the *Gerstle* case, remarked that certain of the features that were mentioned in the *Morrissey* case (296 U.S. 344; 80 L. Ed. 263) as incident to corporate organization were present in the Gerstle Syndicates, saying (95 F. (2d) 587 at p. 589):

"While title to the assets was not taken in the supposed entity or in the syndicate managers, continuity of the enterprises was effected, insuring against disturbance resulting from death or from the transfer of ownership of beneficial interests."

This, no doubt, has reference to the fact that the title to the properties was placed in the name of title companies; as here title was placed in the name of Thomas.

This Court, in the *Gerstle* case, mentioned two characteristic advantages of corporate organization,

viz., "limited liability of the members, and a ready divisability and transferability of beneficial interests, making toward the inclusion in the enterprise of large numbers of participants," and said (p. 589):

> "The liability of the syndicate members was not limited. Their beneficial interests were not readily or conveniently transferable."

Such too was the situation in the case at bar.

We submit that the *Gerstle* case is determinative of the case at bar and on the authority of that case alone the decision of the Tax Court should be reversed.

THE PETITIONERS WERE NOT DOING BUSINESS.

(Specification 24, page 16 hereof.)

We think that we have shown that the decision of the Tax Court is in error in holding that petitioners here are taxable as an association; and if so, that the decision should be reversed.

Moreover, the decision of the Tax Court must be reversed if the petitioners were not doing business, even though it were deemed that they were an "association".

Here Thomas held title to the property in trust. as we have shown; but without power to do any kind of business. *Cleveland Trust Co. v. Commissioner* (C.C.A. 6, 1940), 115 Fed. (2d) 481. The Court there said, at page 483:

> "Business, itself, is a word of large and indefinite import. It is that which occupies the time, attention and labor of men for profit. The word

> 'business' in its present connection connotes a commercial or industrial establishment or enterprise. The distinction between it and 'property' must be clearly kept in mind in applying the taxing statute here. Business in the sense in which it is here used means the activity, the energy, the capacity, the opportunities by which results are reached, the doing of the varied commercial acts and taking of the requisite steps from which result conclusions and conditions.
>
> "The mere receipt of income from leased property and its distribution to cestuis que trustent amounts to no more than receiving the ordinary fruits that arise from the ownership of property and does not constitute doing business. *McCoach v. Minehill Railway Co.,* 228 U.S. 295, 306, 33 S. Ct. 419, 57 L.Ed. 842."

The intention of the Investors was to sell the land as soon as possible. There was no intention to engage in operating or leasing the land for a profit. This intention was never changed. (Specification 11, pages 13-14 hereof.) The stock market crash in October, 1929, made itself felt in the sale of country land during the year 1930. The effect of the depression was such that while by the end of 1930 over 90 per cent of the acreage, viz., 24,828 acres, had been sold for $1,452,-326.06, during the next 10 years 60 acres only were sold for $21,917.00. There would have been no sales in 1935, 1938, 1939, 1940 and 1942 were it not that the land that was sold was required for rights of way for public purposes. (R. 209.) There is a mistake in the findings as to the amount realized from sales after 1940 the amount is stated as $541,843 (R. 217) it

should be $352,600 (R. 218, 189), (Specification 12, page 14 hereof) but it is immaterial.

Efforts to sell the land were continued through 1932, but were relaxed as they became ineffectual because efforts to press sales when there was no market would have produced a harmful effect later when the market should again become active. No reasonable offer was made or refused. The property was not withdrawn from sale. (R. 87.)

Confronted with this condition Clayton had no recourse except (until sales could be made) to operate or rent portions suitable for farming of the then remaining 2,605 acres in order to prevent them from deteriorating and to avoid loss. If the land were ever to be sold it had to be kept in good condition. That was done as a maintenance and salvage operation. But there was no deviation from the original intention to sell the properties as soon as possible. The wait was longer than the Investors expected, but the policy, to sell the land at a profit, was never changed. (R. 86, 87.)

The Tax Court found:

> "The reasons for renting and cultivating the acreage, pending sales were two-fold: To carry the taxes on the property and to keep the property from going 'native', i.e., becoming overgrown with weeds and brush." (R. 217.)

From the time when the lands were acquired in March, 1926, and while selling was most active, Clayton had made leases for one season only of some of the lands under offer of sale and had farmed other portions of the unsold acreage in order to keep the

lands clean and salable, and to meet the taxes and earn incidental income if possible without interfering with the selling operation. (R. 83.)

As these one-season leases expired some were renewed for one season only at a time on lands not then sold.

The practice of renting lands when possible and farming them when necessary, while awaiting buyers, was adopted from the first and was never changed. It was prolonged beyond first expectations because the depression came and lingered. (R. 84, 87.)

No part of the funds originally contributed by the Investors, and no other money, has been invested, or reinvested, to acquire other lands or property, and no exchange of any property has been made. Sales were made only for money and some capital was distributed to the Investors on each sale except small sales made during the depression. All money that has come to the possession of Clayton has been distributed to the Investors as rapidly as possible. There has been no extension of the enterprise into new fields or activities. (R. 87.)

The Tax Court erred in holding that the acquisition of property for the express purpose of resale at a profit is a business undertaking, and erred in holding that the purpose of the investment involved in this case was to make profits by "dealing" in real estate.

(Specification 24, page 16 hereof.)

In *Huron River Syndicate,* 44 B.T.A. 859 (1941), the Board said (pp. 863-864):

"Finally, the original purpose of the *Gerstle* syndicates was the purchase and immediate resale of the respective properties and only business reverses were responsible for its modification; * * * *so that it is questionable whether the Gerstle ventures were originally intended as the vehicle for carrying on a business.* This is a prerequisite to taxability as a corporation, *Chase National Bank of the City of New York, Trustee,* 41 B.T.A. 430, and in fact *the Board found that the Gerstle syndicates 'were not organized with the idea of remaining in existence for any substantial length of time or of actively operating in business* * * *'." (Italics supplied.)

Darol Trading Account v. Commissioner, 34 B.T.A. 837 (July, 1936).

In the *Darol* case a group entered a venture to purchase and sell a block of stock. The Board said, after quoting the *Morrissey* case (at p. 839):

"By no stretch of the imagination could it be said that this petitioner was 'carrying on' a business enterprise, within the reasonable interpretation of those words as used by the Supreme Court."

In *Helvering v. Washburn* (C.C.A. 8, 1938), 99 Fed. (2d) 478, upon the death of Washburn, his son, by agreement with the persons having beneficial interests, took title to the property and in turn executed certificates of beneficial interest in the so-called South Texas Syndicate. The purpose in holding the property was to make a profitable sale at the earliest practicable date. The property was leased for grazing

purposes and the income from the leases constituted nearly all the income. With one or two exceptions, no leases for a period of more than one or two years were entered into by the trustee. The Court said, page 481:

> "As said by the Board of Tax Appeals in its opinion: '*There was not an association of individuals in this case for the purpose of carrying on a business.* Washburn simply continued the relationship to the other beneficial owners which his father had with them. All parties have been interested in the sale of the property. Continuous efforts have been made to effect a sale. * * * Greater rentals could be realized if the trust were willing to make long-term leases which would not contain a provision for cancellation upon the sale of its land. This indicates very clearly that there has been no attempt on the part of the trust to *operate a business* for profit'." (Italics supplied.)

It also cited *Commissioner v. Atherton* (C.C.A. 9), 50 Fed. (2d) 740, where it was said, at page 742:

> "In the instant case the trustees are holding parcels of land for an opportunity to sell, collecting rents and paying taxes and distributing available funds, and it is a strict trust."

In the *Washburn* case the Court, after citing the *Morrissey* case, the *Lewis* case and others, said (p. 481):

> "If there is a purpose of immediate liquidation as soon as circumstances will permit, and the carrying on of business is only incidental and necessary for the preservation of the property, no taxable association has resulted."

In *Pitzman, et al., Trustees,* 36 B.T.A. 81 (June, 1937), certain individuals owning as tenants in common a large tract of land, especially adapted for industrial sites, created successive trusts for the management and disposition of the land, the Board said (p. 93):

> "The record shows that the trustees were disposing of the property by sale and lease upon terms which they considered to the best interest of the beneficiaries. It may well be that the sale of this property could have been accelerated by a radical reduction in the sale price, but the law does not require the trustees to sacrifice property in order to hurriedly complete liquidation."

and said (p. 94):

> "The primary purpose in the beginning was to sell and dispose of the property and divide the proceeds. That purpose was manifest throughout both trusts, and handling of the property by the trustees was consistent to that end. They were not only awaiting an opportunity to sell, but were active in soliciting purchasers. Under these circumstances we do not think the time element in the trust agreements and the delay in making sales have the effect of stamping these trusts as business rather than liquidating trusts."

The Board further said (pp. 94-95):

> "The development included repairs to roads, levees, and tenant houses. * * * Purchases of approximately four acres of land were testified to and reasons amply justifying each purchase were given, one for dedication of land to the Illinois State highway system, and the other to

> close a local roadhouse and gambling resort which was considered harmful to the trust property. We are unable to find in any activity of the trustees an indication that they were conducting a business for profit. Every activity testified to or otherwise shown by the record squares with the purpose of conserving and protecting the trust corpus until such time as it could be sold or disposed of." (Citing *Dauphin Deposit Trust Co., Trustee,* 21 B.T.A. 1214.)

It is clear from the foregoing that a profit motive is not equivalent to a business purpose.

Southern Pile Fabric Co. v. Commissioner, Tax Court Memorandum Decision Docket No. 4968, 3 T.C.M. (C.C.H.) 1264, C.C.H. Dec. No. 14,267 (M), entered November 30, 1944.

A trust which held title to certain land and buildings during the interval from the completion of the building until the time when the prospective purchaser executed its contract to purchase the same was held not to be an association taxable as a corporation. The Tax Court said:

> "There was no conduct of business in the ordinary sense of the word, and it was not contemplated by the parties that there should be any business operations, but that the trustee should act as the conduit through which the rentals should be received, the necessary insurance premiums, taxes and fees paid, and the remainder of the receipts distributed to the beneficiaries. The operation was not changed by reason of the fact that the time for the completion of the purchase was extended on three different occasions and the

> purchase actually completed approximately fifteen years after the execution of the original contract instead of the five years originally contemplated."

We are not unmindful of the language of this Court in *Commissioner v. Atherton* (C.C.A. 9, 1931), 50 Fed. (2d) 740, where it said (p. 742):

> "The controlling feature of a trust is an association of individuals for administration of an estate for liquidation and equitable distribution, and the controlling distinction of an association is an association of individuals for administration of an estate for convenience and profit."

But we submit that the three cases last above cited show that, though petitioners here were not administrating an *estate* for liquidation, what was done in this case was no more carrying on business than was what was done in those cases. The parties in those cases were looking to capital gains, just as were petitioners here. We see no difference in principle.

Any business, financial operation or venture, whether conducted by a partnership or a corporation, is assumed to be inspired by the profit motive. To "carry on" a business (the phrase used in section 3797 of the Internal Revenue Code) implies an intention to carry on a business through an indefinite series of transactions to seek profits rather than capital gains. It implies a continuity of business purpose.

The opinion of the Tax Court cites *Sloan v. Commissioner*, 24 B.T.A. 61, 63 Fed. (2d) 666; *Adelaide*

Park Land, 25 B.T.A. 211; and *Bing & Bing, Inc.*, 35 B.T.A. 1170; to the point that the acquisition of property for the express purpose of resale at a profit is a business undertaking. The cases do not sustain the point, for in each of those cases the entity under consideration had power to improve the property that it was buying and selling, and indeed in the *Bing* case the powers were virtually without limit.

THE CASES CITED BY THE TAX COURT AS DETERMINATIVE ARE DISTINGUISHABLE FROM THE CASE AT BAR.

The Tax Court, in its opinion (R. 220) cited, as controlling the question whether there was an association taxable as a corporation, *Morrissey v. Commissioner*, 296 U.S. 344, 80 L.Ed. 263; *Helvering v. Combs*, 296 U.S. 365, 80 L.Ed. 275; *Huron River Syndicate*, 44 B.T.A. 859; *Helm & Smith Syndicate v. Commissioner*, 136 Fed. (2d) 440; *Bing & Bing, Inc.*, 35 B.T.A. 1170; and *Kilgallon v. Commissioner*, 96 Fed. (2d) 337.

They are all distinguishable from the case at bar.

In *Morrissey v. Commissioner, supra*, and *Helvering v. Combs, supra*, the title to the property was held by trustees who were charged with the performance of all activities in connection with the enterprise. In the case at bar, the legal title to the property was held by Thomas in trust for the respective petitioners, who as equitable owners and tenants in common carried on all activities through their agent Clayton.

In *Huron River Syndicate*, 44 B.T.A. 859, *supra*, the declaration of trust expressly provided that the interests of the beneficiaries (at p. 861):

> "*are not interests in the property enumerated and forming the subject of said trust, but are the rights to the performance of said trust and the distribution of the net profits to be derived therefrom and distribution of any trust property remaining on termination of said trust according to the foregoing declaration. Said interest is personal estate and not real estate.*" (Italics supplied.)

The individuals there also agreed that if the enterprise should be transformed into a corporation,

> "the duties which petitioner would then perform as director, president, and manager would be 'as nearly as may be the duties which he has undertaken hereunder as trustee'; thus indicating that his relationship to the participants in the enterprise was to be as nearly as possible comparable to that of the managing officer of a corporation."

In *Helm & Smith Syndicate v. Commissioner* (C.C.A. 9, 1943), 136 Fed. (2d) 440, there were three successive forms of organization. The first and third were trusts which were held to be associations taxable as corporations. These were distinguished by this Court, on page 441, from the *Gerstle* case [(C.C.A. 9, 1938), 95 Fed. (2d) 587)] *supra*, and the *Rector & Davidson* case [(C.C.A. 5, 1940), 111 Fed. (2d) 332] *supra*, this Court saying:

"The provision for a governing directorate with the usual managerial functions distinguishes this case from *Commissioner v. Gerstle* * * * and *Commissioner v. Rector & Davidson* * * *."

And, we may add, distinguish it from the instant case. In the second form of organization in the *Helm* case (136 Fed. (2d), foot of page 440), each of the beneficiaries under the trust conveyed his former beneficial interest in the trust to Helm, who, as their agent, administered the property formerly held in the trust. In that respect it was like the case at bar. That agency continued but a short time during which Helm leased certain of the property and sold a parcel thereof receiving income therefrom in that period. This Court said (pp. 441, 442):

"We are unable to see any ground for the Tax Court's holding that the income from the sales and leasing by Helm after the dissolution of the first trust was income to an association under the Act, and hold that such income was not so taxable."

The *Helm* case thus makes very clear the distinction between the instant case as decided by the Tax Court and, as we see it, where Clayton, like Helm, is an agent, and there is no association taxable as a corporation.

Bing & Bing, Inc., 35 B.T.A. 1170, is cited by the Tax Court as one of the cases by which it says the question here is controlled. (R. 223.) The Tax Court also says, "The facts show that the Bloomfield or the Miller & Lux Syndicate was substantially the same as the Carbarn Syndicate in Bing & Bing, Inc." In

Bing & Bing, Inc., contrary to the situation here, the manager was to use the funds contributed, for various purposes described *"and for such other purposes as in the judgment of the manager may be advisable"*, (italics supplied), 35 B.T.A. p. 1170, 1171. The same syndicate that was considered in *Bing & Bing* was also considered in *Glenmore Securities Corp.*, 24 B.T.A. 697, and we learn from the language of the agreement quoted there, pp. 698 and 699, *"the amount of the moneys to constitute said Carbarn Syndicate Fund shall be determined solely by the Manager and shall be increased or diminished in amount from time to time at any time as determined by the Manager in its sole discretion"*. (Italics supplied.) The agreement further provided, 24 B.T.A. p. 699, that when the Syndicate was terminated at the option of the manager there should be a distribution of all assets and profits "though there may be a partial distribution at any time prior thereto *in the discretion of the Manager"*. (Italics supplied.) The power given to the manager to determine the amount of money to constitute the fund, which might be increased or diminished from time to time as determined by the manager in its sole discretion, and also the right to determine when the Syndicate should terminate, and also the discretion given to it as to when distributions should be made, coupled with the power to use the funds contributed for such purposes as in its judgment might be advisable, bring into the *Bing* case elements of corporate financial structure and capital funds for a continuing enterprise closely resembling those exist-

ing in a corporation, none of which appear in the case at bar.

The Tax Court also cites the *Bing* case to show that the acquisition of property for the express purpose of resale at a profit is a business undertaking. (R. 221.) This suggestion is fully answered by the provisions of the agreement in the *Bing* case, which go far beyond the acquisition of property for resale. There the fund subscribed was to be used for "the *purchase, ownership, sale, management, development and/or exchange* of said above described premises *and/or improvement by construction of buildings or other structures on the said described premises and for the payment of any and all expenses, costs and other disbursements incident thereto, and for such other purposes as in the judgment of the Manager may be advisable.*" (Italics supplied.) It is noteworthy that the managers in the *Bing* case brought about the incorporation of Temple Terrace Construction Company for the purpose of building thirty houses in Temple Terrace Subdivision, Tampa, Florida, and the Syndicate members were called on to contribute to that purpose and later made further advances in an endeavor to save losses in that transaction.

We think the *Bing* case needs no further discussion.

Kilgallon v. Commissioner (C.C.A. 7, 1938), 96 Fed. (2d) 337, also cited by the Tax Court as a controlling case, differs radically from the case at bar. There the trust agreement, Article I, declared (96 Fed. (2d) 337) the object of the trust to be "*the acquisition, management, improvement and disposition*

*of the said premises and of such other property as may be acquired from time to time * * *"* (italics supplied), and Article III provided, in part "And the beneficiaries can have no claim, right, title or interest, legal or equitable in the land or other assets or property at any time held by the Trustee under this Trust, but their interest shall be only an interest in the net avails or proceeds thereof, which interest shall be assignable and salable in whole, or in part, and shall be construed to be and shall be personal property". The Court said (96 Fed. (2d), page 339):

> "The combined powers of the trustee and managers, taken together with the provisions which created transferable interest, resulted in a centralization and continuity of control by reason of such power, and prevented any interruption in the continuity of the enterprise, through change of ownership of interest, *by separating the interests entirely from the land and making them personal property and assignable and salable as such."* (Italics supplied.)

It is respectfully submitted that the Tax Court erred in holding that petitioners constitute an association taxable as a corporation, and that there are deficiencies in income tax and declared value excess profits taxes for the year 1940 in the respective amounts of $6,646.60 and $4,159.58; and erred in failing to hold that there are no deficiencies in income tax or declared value excess profits taxes for the year 1940.

(Specifications 1, 2, 3, 23, 25, 26, 27, 28, pages 12 and 16 hereof.)

Wherefore, petitioners pray that the decision of the Tax Court be reversed.

Dated, San Francisco,
September 5, 1947.

O. K. Cushing,
Eustace Cullinan,
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(Appendix Follows.)

Appendix.

STATUTES AND REGULATIONS INVOLVED.

"Sec. 3797 [Internal Revenue Code]. (a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * * * *

"(2) Partnership and Partner.—The term 'partnership' includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term 'partner' includes a member in such a syndicate, group, pool, joint venture, or organization.

"(3) Corporation.—The term 'corporation' includes associations, joint-stock companies, and insurance companies."

* * * * * * *

"(b) Includes and including.—The terms 'includes' and 'including' when used in a definition contained in this title shall not be deemed to exclude other things otherwise within the meaning of the term defined."

"Regulation Sec. 19.3797-1. *Classification of taxables.*—For the purpose of taxation the Internal Revenue Code makes its own classification and prescribes its own standards of classification. Local law is of no

importance in this connection. Thus a trust may be classed as a trust or as an association (and, therefore, as a corporation), depending upon its nature or its activities. (See [Reg.] section 19.3797-3.) The term 'partnership' is not limited to the common law meaning of partnership, but is broader in its scope and includes groups not commonly called partnerships. (See [Reg.] section 19.3797-4.) The term 'corporation' is not limited to the artificial entity usually known as a corporation, but includes also an association, a trust classed as an association because of its nature or its activities, a joint-stock company, an insurance company, and certain kinds of partnerships. (See [Reg.] sections 19.3797-2 and 19.3797-4.) The definitions, terms, and classifications, as set forth in [Code] section 3797, shall have the same respective meaning and scope in these regulations."

"Regulation Sec. 19.3797-2. *Association.*—The term 'association' is not used in the Internal Revenue Code in any narrow or technical sense. It includes any organization, created for the transaction of designated affairs, or the attainment of some object, which, like a corporation, continues notwithstanding that its members or participants change, and the affairs of which, like corporate affairs, are conducted by a single individual, a committee, a board, or some other group, acting in a representative capacity. It is immaterial whether such organization is created by an agreement, a declaration of trust, a statute, or otherwise. It includes a voluntary association, a joint-stock association or company, a 'business' trust, a 'Massachusetts'

trust, a 'common law' trust, an 'investment' trust (whether of the fixed or the management type), an interinsurance exchange operating through an attorney in fact, a partnership association, and any other type of organization (by whatever name known) which is not, within the meaning of the Code, a trust or an estate, or a partnership. If the conduct of the affairs of a corporation continues after the expiration of its charter, or the termination of its existence, it becomes an association."

"Regulation Sec. 19.3797-3. *Association distinguished from trust.*—The term 'trust,' as used in the Internal Revenue Code, refers to an ordinary trust, namely, one created by will or by declaration of the trustees or the grantor, the trustees of which take title to the property for the purpose of protecting or conserving it as customarily required under the ordinary rules applied in chancery and probate courts. The beneficiaries of such a trust generally do no more than accept the benefits thereof and are not the voluntary planners or creators of the trust arrangement. Even though the beneficiaries do create such a trust, it is ordinarily done to conserve the trust property without undertaking any activity not strictly necessary to the attainment of that object.

"As distinguished from the ordinary trust described in the preceding paragraph is an arrangement whereby the legal title to the property is conveyed to trustees (or a trustee) who, under a declaration or agreement of trust, hold and manage the property with a view to income or profit for the benefit of beneficiaries.

Such an arrangement is designed (whether expressly or otherwise) to afford a medium whereby an income or profit-seeking activity may be carried on through a substitute for an organization such as a voluntary association or a joint-stock company or a corporation, thus obtaining the advantages of those forms of organization without their disadvantages. The nature and purpose of a cooperative undertaking will differentiate it from an ordinary trust. The purpose will not be considered narrower than that which is formally set forth in the instrument under which the activities of the trust are conducted.

"If a trust is an undertaking or arrangement conducted for income or profit, the capital or property of the trust being supplied by the beneficiaries, and if the trustees or other designated persons are, in effect, the managers of the undertaking or arrangement, whether the beneficiaries do or do not appoint or control them, the beneficiaries are to be treated as voluntarily joining or cooperating with each other in the trust, just as do members of an association, and the undertaking or arrangement is deemed to be an association classified by the Internal Revenue Code as a corporation. However, the fact that the capital or property of the trust is not supplied by the beneficiaries is not sufficient reason in itself for classifying the arrangement as an ordinary trust rather than as an association.

"By means of such a trust the disadvantages of an ordinary partnership are avoided, and the trust form affords the advantages of unity of management and

continuity of existence which are characteristic of both associations and corporations. This trust form also affords the advantages of capacity, as a unit, to acquire, hold, and dispose of property and the ability to sue and be sued by strangers or members, which are characteristic of a corporation; and also frequently affords the limitation of liability and other advantages characteristic of a corporation. These advantages which the trust form provides are frequently referred to as resemblance to the general form, mode of procedure, or effectiveness in action, of an association or a corporation, or as a 'quasi-corporate form.' The effectiveness in action in the case of a trust or of a corporation does not depend upon technical arrangements or devices such as the appointment or election of a president, secretary, treasurer, or other 'officer,' the use of a 'seal,' the issuance of certificates to the beneficiaries, the holding of meetings by managers or beneficiaries, the use of a 'charter' or 'by-laws,' the existence of 'control' by the beneficiaries over the affairs of the organization, or upon other minor elements. They serve to emphasize the fact that an organization possessing them should be treated as a corporation, but they are not essential to such classification, for the fundamental benefits enjoyed by a corporation, as outlined above, are attained, in the case of a trust, by the use of the trust form itself. The Internal Revenue Code disregards the technical distinction between a trust agreement (or declaration) and ordinary articles of association or a corporate charter, and all other differences of detail. It treats

such a trust according to its essential nature, namely, as an association. This is true whether the beneficiaries form the trust or, by purchase or otherwise, acquire an interest in an existing trust.

"The mere size or amount of capital invested in the trust is of no importance. Sometimes the activity of the trust is a small venture or enterprise, such as the division and sale of a parcel of land, the erection of a building, or the care and rental of an office building or apartment house; sometimes the activity is a trade or business on a much larger scale. The distinction is that between the activity or purpose for which an ordinary strict trust of the traditional type would be created, and the activity or purpose for which a corporation for profit might have been formed."

"Regulation Sec. 19.3797-4. *Partnerships.*—The Internal Revenue Code provides its own concept of a partnership. Under the term 'partnership' it includes not only a partnership as known at common law but, as well, a syndicate, group, pool, joint venture, or other unincorporated organization which carries on any business, financial operation, or venture, and which is not, within the meaning of the Code, a trust, estate, or a corporation. On the other hand the Code classifies under the term 'corporation' an association or joint-stock company, the members of which may be subject to the personal liability of partners. If an organization is not interrupted by the death of a member or by a change in ownership of a participating interest during the agreed period of its existence, and its management is centralized in one or

more persons in their representative capacities, such an organization is an association, taxable as a corporation. As to the characteristics of an association, see also [Reg.] sections 19.3797-2 and 19.3797-3. The following examples will illustrate some phases of these distinctions:

"(1) If A and B buy some acreage for the purpose of subdivision, they are joint adventurers, and the joint venture is classified by the Internal Revenue Code as a partnership.

"(2) A, B, and C contribute $10,000 each for the purpose of buying and selling real estate. If A, B, C, or D, an outside party (or any combination of them as long as the approval of each participant is not required for syndicate action), takes control of the money, property and business of the enterprise, and the syndicate is not terminated on the death of any of the participants, the syndicate is classified as an association."